

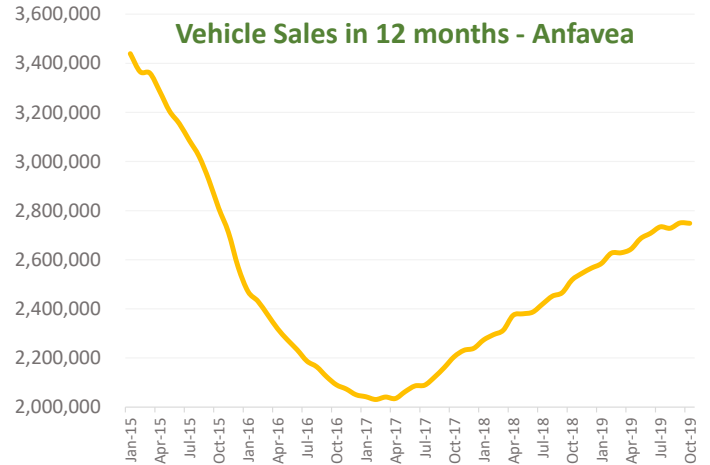


BRAZIL: MACROECONOMIC MONITOR AND REFORM AGENDA

November 11, 2019

Week Highlights

- The auction of pre-salt areas in Bacia de Santos, related to the excess of production of the onerous assignment agreement, generated R\$ 69,9 billion in revenues for federal, states and municipal governments.
- The COPOM Minutes reinforced the message that, starting from the additional cut signaled for December, a more cautious approach will be adopted. The text also pointed out that, with the current reduction in state participation in the economy, the changes in the credit market and financial intermediation, with a greater role of free resources and capital markets, may impact the transmission of monetary policy.



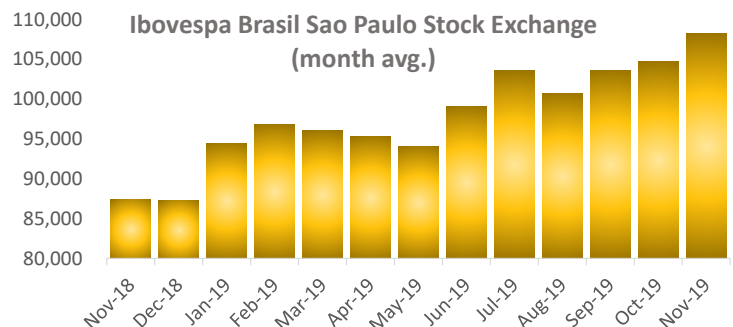
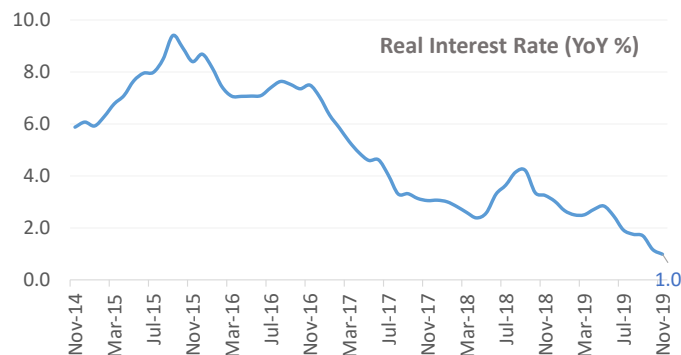
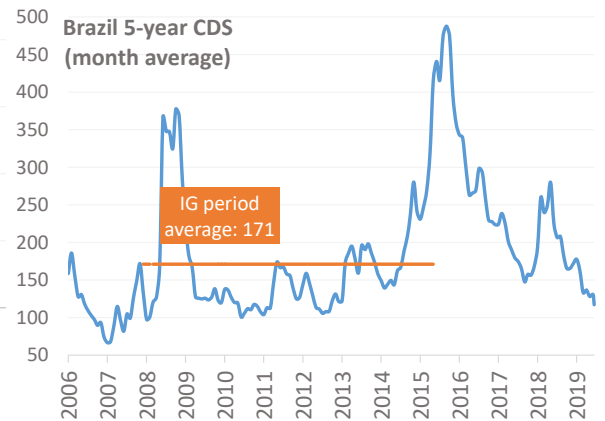
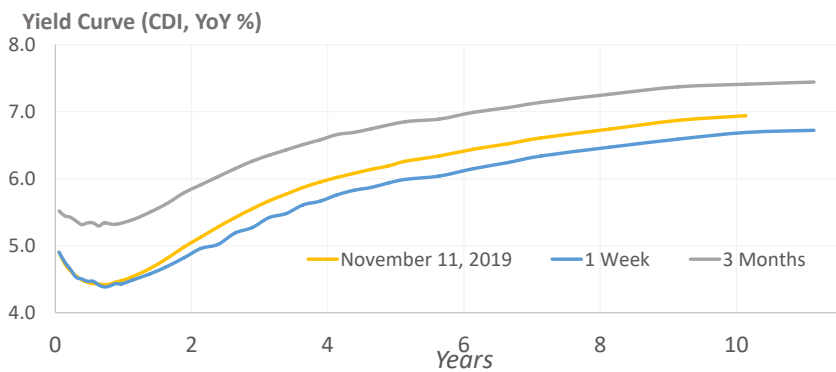
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More Brazil: The transformation of the Brazilian State

	2014	2015	2016	2017	2018	2019	2020
GDP (% YoY)	0.50	-3.55	-3.30	1.06	1.12	0.92 (*)	2.08 (*)
Consumer Inflation IPCA (% YoY)	6.41	10.67	6.29	2.95	3.75	3.31 (*)	3.60 (*)
Current Account (USD bi)	-101.4	-54.5	-24.2	-15.0	-21.9	-34.7 (*)	-37.8 (*)
Foreign Investment in the Country (USD bi)	87.7	64.7	74.3	68.9	76.8	80.0 (*)	80.0 (*)
International Reserves (USD bi)	364	356	365	374	375	369 (07 Nov)	-
Unemployment rate (%)	6.5	8.9	12.0	11.8	11.6	11.8 (Sep)	-
General Government Gross Debt (% GDP)	56.3	65.5	69.9	74.1	77.2	79.4 (**)	80.3 (**)
Ibovespa Index (BRL, % chg.)	-2.9	-13.3	38.9	26.9	15.0	22.2 (ytd)	-
CDS 5 years (year average)	189	475	293	165	208	154 (Nov 19)	-
Interest rate (Selic Target) (% eop)	11.75	14.25	13.75	7.50	6.50	4.50 (*)	4.50 (*)

Estimates: (*) Focus Survey, Central Bank of Brazil, Nov. 8, 2019; (**) Prisma Fiscal, Oct.2019

MARKET WATCH



Swap Pre x Di 360 days discounted of the IPCA Expectation for the next 12 months

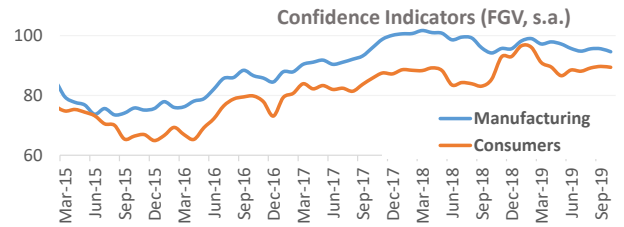
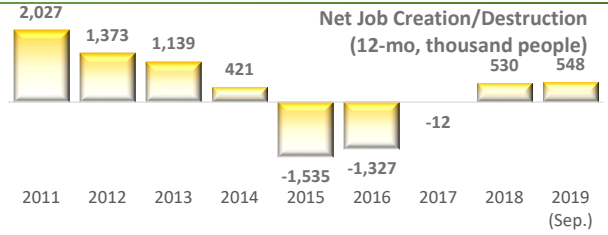
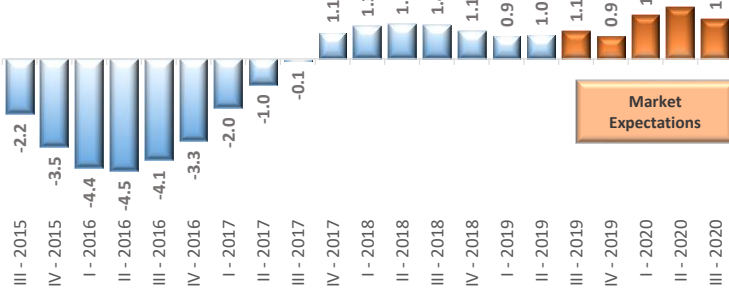
Sources: BCB, Min. of the Economy, Bloomberg



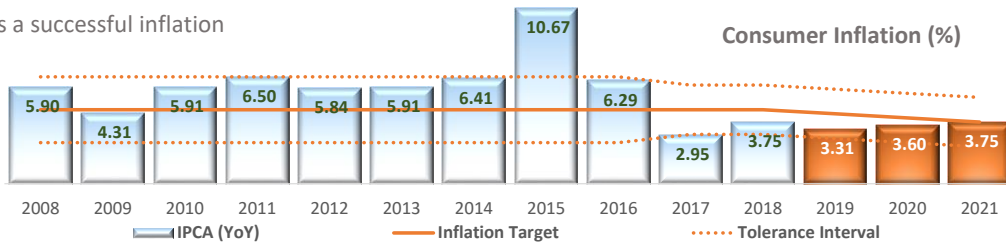
ECONOMY WATCH

A more robust recovery is still dependent on further advances in the reform agenda

Gross Domestic Product
(% change in 4Q)

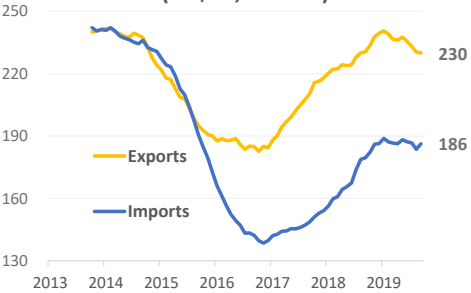


The country runs a successful inflation target regime

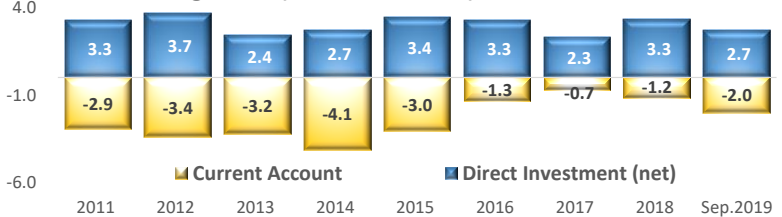


The external accounts are one of the main pillars of the Brazilian economic stability

Trade Balance (US\$ bi, 12-mo.)

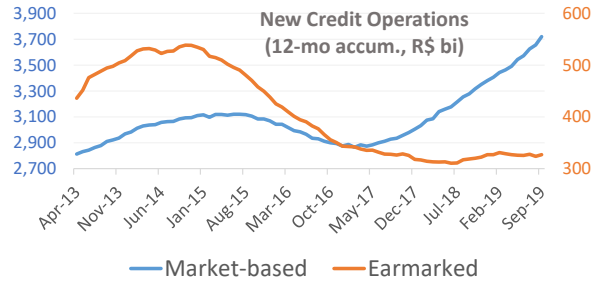


External Financing Needs (% of GDP, 12-mo.)

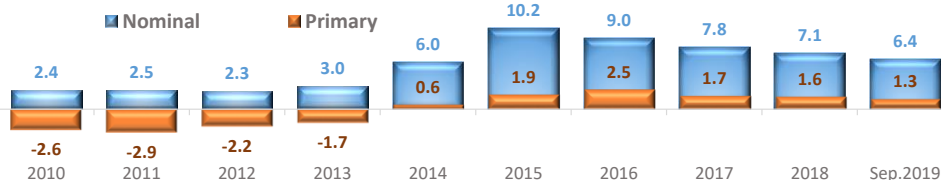


The credit market went through an adjustment process and now favors market-based operations

Household Debt Service ratio (% YoY)



Public Sector Fiscal Deficit (% of GDP)



Brazil is working to improve its fiscal sustainability



Fiscal consolidation and productivity increase are crucial inputs for Brazil to grow strongly and sustainably. The new government is going forward to put in place a set of reforms for speeding up growth and increasing potential output.

Main Measures

Social Security

- Brazil had been spending more than half of the Federal budget on social security and benefits. Gen. Govt. Gross Debt projections pointed to an unsustainable path.
- The reform approved in October increases the time to retire, limits benefits, raises the rates of contribution for those who earn above the INSS ceiling and establishes rules of transition.
- The reform will stabilize social security expenditures in 8.5% of GDP from 2022 on. Its impact is projected as around BRL 0.8 trillion in 10 years.
- Law 13,846/19 reviews benefits and proceedings with suspected irregularities, and changes rules for granting benefits, such as reclusion allowance, death pension and rural retirement. The goal is to save about R\$ 9.8 billion in the first year.

Next Steps

- Bill 1,646/19 creates measures to facilitate the collection of debt with the Social Security.
- PEC 133/19 extends the reform for States and Municipalities. Senate's second round of voting is scheduled for Nov. Savings of R\$ 0.4 trillion.

Tax Reform

- Brazil needs to simplify the tax system and to reduce the tax burden on companies, the legal insecurity and the excessive legal dispute
- Instrument: PEC and infra constitutional measures.

Next Steps

- Legislation being prepared

Trade Liberalization

- The EU-Mercosur Free Trade Agreement was announced by both parties on June 28. The Free Trade agreement is to be ratified by all Parliaments involved.
- Aims at increasing the openness degree (exports plus imports over GDP) from 22% to 30% of GDP in four years.
- 2019 initiatives include: the end of quantitative restrictions on the free trade agreement of autos with Mexico; Free trade agreement with the European Free Trade Area (EFTA); modernization of tax agreements; agreement with Sweden to end the double taxation of income tax; import tax reduced to zero on over 1,000 industrial machines and equipment not produced domestically; reduction of the import tax for inputs and products of the chemical sector.

Next Steps

- Expand the Agreement for Economic Supplementation with Mexico
- Trade agreement with the US
- Trade agreement talks with South Korea, Japan, Canada
- Instruments: Government decrees and resolutions

Economic Freedom

- Economic Freedom Law: reduces red tape and Government intervention, facilitating the opening of new businesses.
- Eliminates the need for low-risk activities to obtain any type of license; limits restrictions on working hours for commerce, services and industries; prevents laws to define prices; establishes a binding and isonomic treatment for similar situations; overrules outdated legislation; eliminates license requirements for testing, developing or implementing a product/service that does not pose high risks; impedes judicial changes in business contracts; establishes that unanswered license requests are automatically granted; extends higher court decisions to all cases; creates the "regulatory abuse" situation; among others issues.

Digital Government

- The Brazilian government transformed 400 public services and made them 100% digital.
- Four key goals to be achieved by the end of 2020: i) launch a new digital identity, based on biometrics, for over 100 million Brazilians; ii) ensure that 70% of the over 3,000 services are digital; iii) consolidate government digital channels; iv) simplify business registration.
- Current initiatives include The Digital Citizenship Platform (access and provision of digital public services); GovData (main official databases); and ConectaGov (connection of govt. systems).

Next Steps

- Broader digital integration, services provision, and database unification; Changes in the legal framework; among others.

Fight corruption, criminal organizations and violent crimes

- Changes to the Code of Criminal Procedure, Criminal Code, Criminal Law, Electoral Code, and others;
- Measures will help reduce costs of doing business. Include the provisional execution of a criminal conviction after second instance sentences; the criminalization of irregular funding in elections; tighter sentences and penalties increase.

Next Steps

- Submitted to Congress on Feb.
- 3 Infra constitutional instruments (PL-881/2019, PL-882/2019 and PLP-38/2019)

Ombudsman for Direct Investments

- Provide consultation for foreign investors about legislation or administrative procedures related to investments in Brazil.



Main Measures

Employment

- The registers of the unemployed were opened to private recruitment companies, extending the use of the national employment system dataset.

Next Steps

- *Carteira Verde e Amarela* to ease access to the labor market.
- *Emprega Mais*: new workforce training strategy.

Central Bank Independence (Senate PLP 19/19)

- Bill establishing formal independence to the Central Bank of Brazil. It comprises a four- to eight-year term for the directorate of the institution, with no overlapping with the presidential mandate; and the end of ministerial status given to the president of the Bank.

Next Steps

- Congress appreciation
- Instrument: Supplementary Bill.

Subsidies reduction

- Reduction and streamlining of subsidies granted by the Government, which amount to around 4.7% of GDP in the 2019 budget.

Next Steps

- Congressional approval

Fiscal sustainability of subnational entities (PLP 149/2019)

- The Fiscal Balance Plan will aid States and Municipalities in financial distress to achieve fiscal adjustment, allowing the access to loans guaranteed by the Federal Government. Entities must provide the counterpart of recovering their payment capacity.

Next Steps

- Congress appreciation

Public administration overhaul (Decree 9.725/19)

- 21,000 commissioned positions eliminated; limitations for creating collegiates and elimination of unnecessary collegiates; restrictions for hiring civil servants and rules for hiring senior officials.

Next Steps

- Congressional approval

Privatization

- As of Aug. 1st, there are 130 companies owned by the Fed. Govt.
- On June 06, 2019, the Supreme Court ruled that subsidiaries (which comprise more than half of the companies) do not need Congress approval to be sold.
- The announced target for 2019, already met, was US\$ 20.0 billion.

INVESTMENTS, CONCESSIONS AND PRIVATIZATIONS

52 PPI Projects Auctioned or Renewed

<ul style="list-style-type: none"> • Privatization of 7 Distributors (CELG, CEAL, CEPISA, CERON, Eletroacre, Amazonas, Boa Vista) • Concessions of 2 Hydroelectric Plants (Jaguara, UHE) and 2 Small Plants • Transmission Lots and Stations 	<ul style="list-style-type: none"> • 4th Marginal Fields Round • 14th, 15th, 16th Exploratory Blocks Bidding Round • 2nd to 6th Pre-Salt Production Sharing Bidding Rounds 	<ul style="list-style-type: none"> • 5 Extensions and 1 Concession (Norte-Sul) 		
<ul style="list-style-type: none"> • 16 Concessions 	<ul style="list-style-type: none"> • 20 Projects (leasing, extension or assignment agreement) 	<ul style="list-style-type: none"> • Concession of Rodovia da Integração do Sul 	<ul style="list-style-type: none"> • Privatization of CASEMG 	<ul style="list-style-type: none"> • Concession of Lotex

117 ongoing PPI Projects

<ul style="list-style-type: none"> • Transmission Lots • 2 Auctions of New Energy • 4 Hydroelectric Plants (environm. license) 	<ul style="list-style-type: none"> • Angra 3 Plant 	<ul style="list-style-type: none"> • 4 Mining Rights • 1 sale of assets 	<ul style="list-style-type: none"> • 14 Marginal Fields Areas • Auction of Assignment Agreement 	<ul style="list-style-type: none"> • São Francisco River Integration Project 	
<ul style="list-style-type: none"> • 6th Round (North I, South and Central) 	<ul style="list-style-type: none"> • 15 Leasings • 2 Privatizations • 2 New Investments • 1 Privatization Study 	<ul style="list-style-type: none"> • 11 Concessions • 1 environmental license 	<ul style="list-style-type: none"> • Privatization: Casa da Moeda, CEASAMINAS, Infraero shareholdings, Eletrobras, CEAGESP, ABGF, EMGEA, Correios, Dataprev, Serpro, CEITEC, Telebrás, BB shares • PPP for COMAER 		
<ul style="list-style-type: none"> • 10 Concessions 	<ul style="list-style-type: none"> • Concessions of Iguazu, Lençóis Maranhenses and Jericoacoara 	<ul style="list-style-type: none"> • PPPs for prisons and for police comm. • Studies for street lighting against violent crimes and for socioeducational measures 	<ul style="list-style-type: none"> • Studies for universalization and urban solid waste energy recovery 	<ul style="list-style-type: none"> • CBTU • Trensurb 	<ul style="list-style-type: none"> • Study: child education



Airports

38 airports

Investments of US\$ 2.1 bi

Signature bonuses of US\$ 0.6 bi

Airports	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
6th round - South Block (9)	●			3Q20	4Q20
6th round - Northern Block 1 (7)	●			3Q20	4Q20
6th round - Central Block (6)	●			3Q20	4Q20
Disposals of Infraero shares (4)	●				

Railroads

Investments of US\$ 14.8 bi

Extension of 15,107 km

Signature bonuses of US\$ 0.7 bi

Railroads	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
EF-334 – FIOEL	✓	●		1Q20	2Q20
EF-170 – Ferrogrão	✓	●		2Q20	3Q20
EF-354 – Integração Centro-Oeste	●				
North Branch - Ferroanel - São Paulo	●				

Railroads	Studies	Public Hearing	TCU Assessment	Legal Opinion	Subscription
Contract Extension Malha Paulista	✓				3Q19
Contract Extension Carajás (EFC)	✓				4Q19
Contract Extension Vitória-Minas (EFVM)	✓				4Q19
Contract Extension MRS	✓				2Q20
Contract Extension FCA	✓				2Q20

Ports

21 terminals and 2 ports

Investments of US\$ 1.1 bi

Signature bonuses of US\$ 0.2 bi

Ports	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
Port of Suape/PE (SUA05)	✓	✓	✓	● 4Q19	1Q20
Port of Itaquí (IQI 03, 11, 12, 13)	✓	●		1Q20	2Q20
Port of Santos/SP (STS 14, 14A)	✓	●		1Q20	2Q20
Port of Paranaguá/PR (PAR12)	●			2Q20	3Q20
Rental of Solid Bulks in Port of Aratu/BA (ATU 12)	●			2Q20	3Q20
CODESA Privatization	●			4Q20	2Q21
São Sebastião Privatization	●			1Q21	2Q21
Studies for the Destatization of Port of Santos	●			3Q21	4Q21
Port of Suape/PE (SUA01)	✓	●			
Port of Paranaguá/PR (PAR07, 08, XX)					
Terminal - Port of Santana (MCP1)					
Cabling Stimulation Policy					

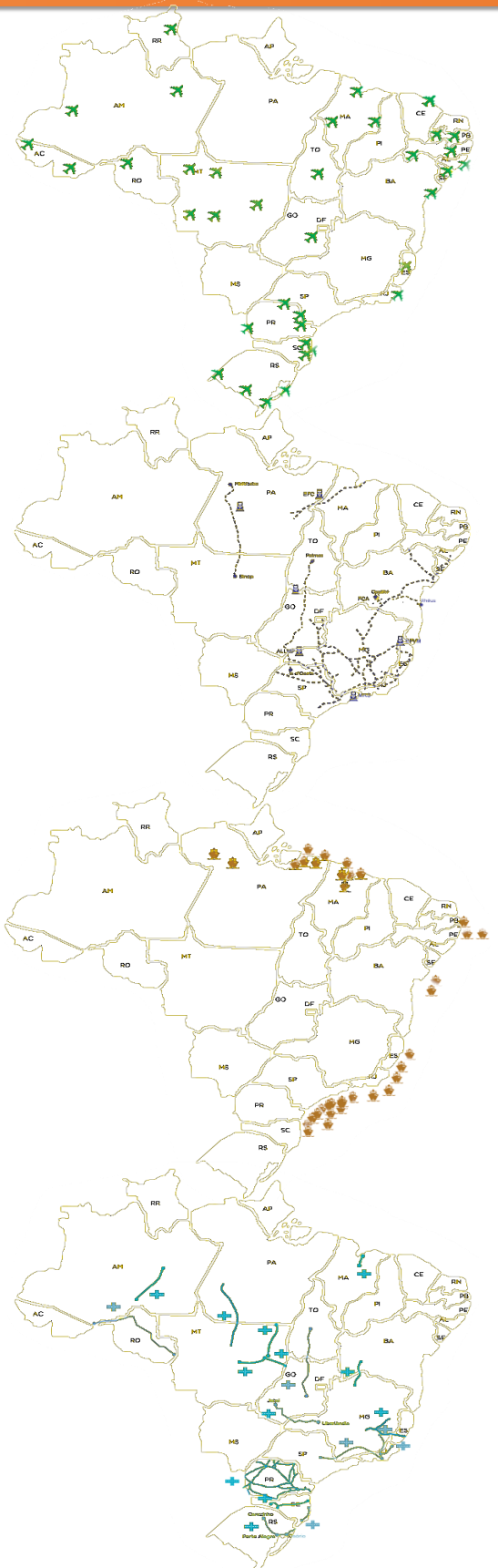
Highways

Investments of US\$ 34.9 bi

Extension of 16,574.82 km

Highways	Studies	Public Hearing	TCU Assessment	Bidding Documents	Auction
BR-364/365/MG/GO	✓	✓	✓	✓	✓
BR-101/SC	✓	✓	●	4Q19	1Q20
BR-381/262/MG/ES	✓	●		2Q20	3Q20
BR-163/230/MT/PA	✓	●		2Q20	3Q20
BR-153/080/414/GO/TO	✓	●		2Q20	3Q20
BR-040/495/MG/RJ (Concer)	●			3Q20	4Q20
BR-116/465/101/SP/RJ (Dutra)	●			3Q20	4Q20
BR-116/493/RJ/MG (CRT)	●			3Q20	4Q20
Integrated Highways of Paraná	●			2Q21	3Q21
BR-153/282/470/SC e SC-412	●			4Q20	1Q21
BR-158/MT					
BR-364/RO/MT					

✓ Completed
● In progress





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More Brazil: The transformation of the Brazilian State

The More Brazil Plan of State Transformation comprises three Proposals of Constitutional Amendments (PEC)

The PEC of the Federative Pact will transfer R\$ 400 bi to States and Municipalities in 15 years

Institutional Framework of the New Fiscal Order

- Representatives of the federal government, the Presidents of the Republic, the House, the Senate, Supreme Court, Court of Audit, governors and mayors will evaluate the financial sustainability of the Federation and ensure solid fundamentals.
- Normative guidance to standardize the interpretation of budget-financial concepts.
- Public programs and works get budget prediction so that resource flows are not interrupted. Ensure that future generations do not inherit current debts.
- Laws and court decisions that generate expenses will only be effective when budgeted.
- Tax benefits will be reevaluated every 4 years. At the federal level, as of 2026, they will not exceed 2% of GDP. If above this ceiling, there can be no new grant, extension or renewal of tax benefits.

Unbinding, Deindexing and Disengaging

- The Federal Government will not provide to subnational governments to pay judicial bonds
- The share of the Workers Support Fund (FAT) allocated to BNDES will be 14%.
- States and municipalities will receive and define the use of all salary-education funds.
- Joint management of education and health earmarked resources.
- Compulsory expenditures will be relaxed in cases of emergency fiscal disarray. Readjustments in social security benefits and BPC by the inflation index are guaranteed.
- Public revenue will not be tied to agencies, funds, or expenses, except for fees, donations, municipal and state participation funds and constitutional bindings.

Federation Strengthening

- Municipalities with less than 5,000 inhabitants and own revenues below 10% of the total revenue will be incorporated by the neighboring municipality. There will be new restrictions on the creation of municipalities.

Autonomy with Responsibility

- Royalties and special interests will be transferred to all states and municipalities.
- The Federal Government will only provide guarantees to operations of states and municipalities with international organizations, starting in 2026.
- Credit operations between entities of the Federation, directly or through funds, local authorities, foundations or state-owned companies are prohibited.
- The Federal Government will be forbidden to provide financial aid to subnational entities, starting in 2026.

New Public Accounts Rules

- Allows public expenditure contingency for states and municipalities.
- Integration of fiscal rules (Fiscal responsibility Law, Golden Rule and Expenditure Ceilings) in all levels of government to ensure the sustainability of public debt.

Legal Security

- The transfer of royalties and special participation of oil will end the disputes between the Federal Government and the states.
- The use of pension funds and judicial deposits between individuals to cover for expenses of the entities is prohibited.

State of Fiscal Emergency

When the Golden Rule (Federal Government) is not met or current expenses are over 95% of current revenues (States), automatic adjustment triggers will come into effect, with restrictions to civil servants' payrolls, promotions, career restructuring and working time; prohibition to create new compulsory expenses and tax benefits, and suspension of FAT transfers to BNDES.

The Emergency PEC will free up to R\$ 50 billion in 10 years

Automatic Adjustment Triggers

	Federative Pact	Emergency
⚡	Fed. Govt., when the Golden Rule is not met	When credit ops. exceed capital expenses in 1 year
⚡	One-year period, renewable	Two-year period
⚡	States and Municipalities, when current expenses exceed 95% of current revenues in 1 year	
⚡	Cannot promote civil servants, create new positions, change careers, make hirings and compensatory payments	
⚡	Cannot create compulsory expenses and tax benefits	
⚡	Allows the reduction of 25% of the servants' working time and payment	
⚡	Saved values destination determined in the budget	25% for infrastructure projects
⚡	Suspends transfers from FAT to BNDES	

Permanent Measures

	Federative Pact	Emergency
⚡	Joint management of health and education resources	-
⚡	Convergence to Golden Rule can be included in the budget	
⚡	Includes pensions expenses in the limit of expenses with personnel	
⚡	Complementary Law to define indicators, sustainable debt levels and debt convergence path	
⚡	Tax benefits reviewed every 4 years from 2026 on, up to a limit of 2% of GDP	
⚡	Destination of tax collection and financial surplus to public debt amortization	

The PEC of the Public Funds will allow a decrease of R\$ 220 billion in the public debt

Current Situation

- There are 281 public funds in Brazil
- There are nearly R\$220 billion parked in funds while the country is in fiscal deficit

Current Issues

- Congress has no power to decide how to use funds resources
- Funds do not allow resource allocation in different areas
- Funds hinder debt management and create budgetary rigidities
- Funds waste money on all levels of government

Measures

- Money already parked in funds will be used in the only legal way, for the payment of public debt
- New resources will be applied primarily to Poverty Eradication and national reconstruction programs
- Most funds will be terminated at the end of the second year following the approval of the PEC
- The creation of new public funds will be made by complementary law

